

RESEARCH

Springfield, Massachusetts; General Obligation

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Credit Profile

ICR

Long Term Rating

BBB/Stable

New

Rationale

Standard & Poor's Ratings Services assigned its 'BBB' issuer credit rating (ICR) to Springfield, Mass., reflecting the city's:

- Low average wealth and income factors,
- Somewhat limited local economy, and
- Sizable unfunded pension liability.

Credit strengths include:

- The presence of the Springfield Finance Control Board (SFCB), which has substantial power to manage the city's budget and implement corrective budget action when necessary; and
- Improved financial performance and position over the past two years due to stronger oversight and management of the city's fiscal affairs, bringing the budget closer to structural balance and increasing revenue flexibility, although challenges remain.

In conjunction with this ICR assignment, Standard & Poor's also assigned its 'AA-' rating to the city's new GO state-qualified municipal purpose loan bonds series 2007. The rating is based on the security of, and the bonds' qualification for, Chapter 44A of the Massachusetts Qualified Bond Act.

Springfield (population 152,082) is in western Massachusetts, about 89 miles from Boston (AA/Stable) and 25 miles north of Hartford (A/Stable). The city is a regional employment center, with jobs focused in the education/health services sector as well as trade/transportation/utilities and professional/business services. The largest employer in the city is Baystate Health Systems (8,772 employees), followed by MassMutual Financial Group (4,230) and the U.S. Postal Service (2,267). Smith & Wesson (587 employees) is the city's largest manufacturing employer. The overall current assessment of the local economy, however, is that it is somewhat limited, which is driving the city's steady contraction in employment and wealth/income factors. Springfield employment measures have historically lagged the commonwealth and national averages. In 2005, the city's unemployment rate was 7.2%, compared with the 4.7% and 5.2% averages for the commonwealth and U.S., respectively. Over the past 36 months, unemployment has remained well above the national rate as both employment and labor force have declined. According to Global Insight, total employment is expected to continue to decline through 2011. Wealth and income measures for the city also remain below commonwealth and national comparisons, and, similar to the employment statistics, the gap has increased over the past three years of data. Median household effective buying income was 62% of the commonwealth average and 71% of the U.S. average, which is also low relative to the wealth figures of similar-sized cities across the nation.

Unless stabilized, the loss of jobs could have a long-term effect on the city's tax base--the future growth of which will be an important factor in maintaining structural budgetary balance between revenues and expenditures. Over the past few years, the tax base has experienced growth partly as a result of property revaluations. In fiscal 2007, total assessed valuation (AV) reached \$7.4 billion, an increase of 50% in five years. Market value is moderate at \$48,879 per capita. Due to the commercial/industrial contraction, the city's tax base has become steadily residential. In 2003, 78% of the total AV in Springfield was residential. This figure has increased to 82% for 2007. Tax collections, which are quarterly, have continued to improve

due to the improved financial management oversight of the SFCB. This has contributed to the improvement of the city's cash flow and to its gains toward structural budgetary balance. Roughly 99% of the city's \$132 million net tax levy was collected by fiscal year-end 2006, which represents a significant improvement from the 93% and 94% rates of fiscals 2002 and 2003, respectively.

Springfield has had a history of chronic fiscal imbalance, which culminated in a \$41 million projected general fund balance deficit for the fiscal 2005 budget and the establishment of the SFCB. The accumulated deficits significantly weakened the city's cash flow and its ability to meet payroll obligations and other general fund operating requirements. The Massachusetts Legislature enacted Chapter 169 of the Massachusetts General Laws to attempt to stabilize the city's fiscal condition and restore long-term fiscal stability. The act created the SFCB and gave the city access to a special trust fund of up to \$52 million for no-interest loans to address its deficit and budgetary needs. SFCB has substantial power to manage Springfield's budget and implement corrective budget action when necessary. Over the past three years, some progress has been made on key budget and financial issues, including the following:

- An improvement in financial monitoring and planning was seen, including regular intrayear revenue expenditure reporting and an updated capital improvement program (CIP).
- Budgeting was improved, marked by the use of conservative revenue assumptions.
- City departments were reorganized following comprehensive assessments, resulting in a reduction in staff by 478 full-time-equivalent employees.
- \$22.5 million in back taxes, plus interest charges, was collected.
- The city's management and financial management systems were overhauled and fully integrated with the school department.
- The city reached settlement on 27 of 28 collective bargained union contracts. The settlements eliminated a \$40 million liability associated with back-wage and health insurance-related litigation that had been filed by unions. The majority of these contracts extend out seven years with 3% average annual increases, providing budget certainty for a large expenditure line item.
- The city became the first municipality in Massachusetts to participate in the state-run Group Insurance Commission. The commission's historic year-to-year cost increase is 9%, compared with 15% for the city, which is expected to generate meaningful savings.
- The city improved its liquidity while reducing its reliance on cash flow borrowings. From 2002-2004, Springfield needed \$35 million per year, on average, for cash flow purposes. In 2005 and 2006 it borrowed less than \$2 million from the trust fund for cash flow, which was repaid by year-end.
- A fiscal stability reserve, which reserves fund in the general fund, was established along with a separate nongeneral fund capital reserve fund.
- The Springfield Contributory Retirement System's assets were transferred to the commonwealth's pension fund manager, called PRIM, effective 2005, which is expected to improve the city's rate of return to smooth year-to-year actuarially required contributions.

During fiscal 2005, the SFCB initiated a series of cost-cutting measures, such as tighter expenditure controls, significant staff reductions, and a wage freeze, which, along with positive revenue variances and onetime sources, led to a budgetary surplus of \$14 million. This was a significant improvement from the original projected budget deficit of \$37 million. General fund results improve when the \$21 million transfer in from the trust fund is included. In total, general fund balances increased substantially to \$50.9 million, which was equal to roughly 11% of the city's operating budget. This includes a fiscal stability reserve of \$4.3 million. Of the total general fund equity, \$26.5 million was unreserved, equal to roughly 6% of expenditures. Nongeneral fund improvements in fiscal 2005 included the reduction of a \$6.1 million deficit in the city's health insurance internal service fund, as well as a \$1.9 million balance in a capital reserve fund, which was created pursuant to Chapter 169.

Despite budget growth of less than 3%, the city entered fiscal 2006 with a projected operating deficit of \$6.5 million for which it drew down a comparable amount from the special trust fund. Improved financial management and positive budget variances led to a surplus of approximately \$7 million. Positive revenue variances included collection of roughly \$11.5 million in outstanding back-taxes and strong investment returns. The unreserved general fund balance closed at \$48 million, equal to 10% of expenditures. The fiscal 2007 budget was adopted as a balanced budget with no trust fund support. The city implemented a trash fee, the projected funds of which were used to balance the budget. Since its adoption, the implementation and collection of the trash fee has been stayed by a court order, resulting in the loss of a projected \$2.6 million. Should this amount not be made up by a favorable variance in another area of the budget, the city could draw upon the trust fund to meet its budgetary needs.

The city's current debt burden is low to moderate, although future capital needs are sizable due to chronic deferred capital maintenance. Net of state school construction assistance, the debt burden is \$1,387 per capita, or 2.8% of market value. Over the next five to seven years, the city expects to address \$350 million

in capital projects. Of that amount, more than half is projected to be offset by reimbursements from the Massachusetts School Building Authority. Aside from the liability associated with the repayment of the trust fund loans, the city's large pension obligations represent an additional future liability. As of Jan. 1, 2005 (the date of the latest valuation), Springfield's pension was 42.6% fully funded, with the unfunded actuarial accrued liability at \$372 million. If this liability is included in the debt burden calculation, debt per capita increases to \$3,844, or nearly 8% of market value. The city is currently in the process of estimating its other postemployment benefits liability.

Outlook

The stable outlook on the ICR is based on the expectation that the city will adhere to the new financial policies and practices the SFCB has established, allowing financial operations to remain positive as the city begins to address its capital needs. Springfield's future credit direction will depend on its progress in maintaining structural budget balance, continued progress in addressing its unfunded pension liability, and the stability and growth of the tax base.

Springfield Finance Control Board

In July 2004, the Massachusetts Legislature enacted Chapter 169 of the Massachusetts General Laws, titled "An Act Relative to the Financial Stability of Springfield." Chapter 169 established the SFCB, with comprehensive authority over all city finances, including appropriations, borrowings, transfers of funds, and municipal spending authorizations. The act also established a \$52 million trust fund for the city, to be controlled by the SFCB, from which interest-free loans can be disbursed. For fiscals 2005 and 2006, the city had drawn down \$23 million from the trust fund to be used to balance its budget and offset its budgetary deficits.

Chapter 169 provides that if the SFCB concludes that its powers are insufficient to restore fiscal stability to the city, the commonwealth's secretary for administration and finance can terminate the SFCB and appoint a receiver for the city. Upon appointment of a receiver, the office of mayor would be abolished and other elected officials would serve solely in an advisory capacity.

As of June 20, 2006, the city had borrowed \$23 million of the \$52 million trust fund established pursuant to Chapter 169. The terms of the loan require that this be repaid over a five-year period commencing in fiscal 2008. The city's current financial projections assume a repayment schedule of \$5.2 million per year through fiscal 2012, although the city is seeking loan forgiveness.

Financial Management Assessment: Strong

Springfield's management practices are considered strong under Standard & Poor's Financial Management Assessment (FMA) methodology due to the policies and practices the SFCB is expected to adopt. An FMA of strong indicates that the city's financial practices are strong, well embedded, and likely sustainable. The FMA is designed to measure city management policies and procedures.

These policies and procedures include:

- A formal five-year CIP that is updated annually and includes identified funding sources;
- A formal reserve policy that the city maintain its undesignated general fund balance and separate stabilization fund between 5%-15% of general fund revenues each, along with provisions for how reserves would be replenished if they dropped below that floor;
- Five-year financial forecasting, which is based on conservative and historical-driven budget assumptions; and
- Formal budget monitoring with monthly reporting.

More weight as a credit strength will be given as these policies are adopted and followed by the SFCB and codified into the city charter and budget.

Ratings Detail (As Of 09-Jan-2007)

Springfield ICR

Long Term Rating

BBB/Stable

New Rating

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